

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Lempert Analyst: Roger Lackey Bill Number: AB 1774
Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 01-20-00
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: NOL Deduction Carryovers/Increase Percentage and Length of Carryover

SUMMARY

This bill would incrementally increase the general net operating loss (NOL) deduction carryforward amount from 50% of the total net operating loss for taxable and income years beginning before January 1, 2000, to 55% of such amount for taxable and income years beginning on or after January 1, 2000, and before January 1, 2002, and to 60% of such amount for taxable and income years beginning on or after January 1, 2002. Additionally, this bill would increase the period to carry forward an NOL from the current five years to ten years for all NOLs generated for taxable and income years beginning on or after January 1, 2000. The bill would retain current preferential NOL treatment for new and small businesses.

EFFECTIVE DATE

This bill would be effective for taxable and income years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 724 (1997/1998, failed passage) would have incrementally increased the NOL carryforward over five years, until California law conformed to federal law (100% carryover), except California law would have continued to not allow carrybacks.

SPECIFIC FINDINGS

Federal law provides that an NOL can be carried back two years and forward 20 years. An NOL is defined as the excess of allowable deductions over gross income computed under the law in effect for the loss year.

Existing state law conforms to the federal computation of the NOL. California does not allow NOL carrybacks. Depending on the type of taxpayer or amount of a taxpayer's income, the amount of the NOL that is eligible to be carried forward and the number of years it can be carried forward will vary.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald H. Goldberg

2/24/00

Existing state law provides for seven different types of NOLs:

Type of NOL	NOL % Allowed to be Carried Over	Carryover Period
General NOL	50%	5 Years
New Business Year 1	100%	8 Years
Year 2	100%	7 Years
Year 3	100%	6 Years
Eligible Small Business	100%	5 Years
Specified Disaster Loss	100%	5 Years
	50%	10 Years
TTA, LAMBRA & EZ	100%	15 Years

Generally, for most taxpayers, 50% of the computed NOL may be carried forward for five years. Special NOL treatment as stated in the above chart is provided for the following taxpayers:

- New Businesses that are in a trade or business activity that first commenced in California after January 1, 1994. "New Business" special NOL treatment also applies to taxpayers engaged in certain biopharmaceutical activities for taxable or income years beginning on or after January 1, 1997, who have not received approval for any product from the U.S. Food and Drug Administration.
- Eligible Small Businesses that are in a trade or business with gross receipts, less returns and allowances, of less than \$1 million during the taxable or income year.
- Taxpayers that suffer a casualty loss in an area declared a disaster area by the Legislature may carry over 100% of an NOL for five years and 50% of any NOL remaining after the first five years for an additional 10 years.
- Taxpayers that operate a business in a Local Agency Military Base Recovery Area (LAMBRA), Targeted Tax Area (TTA) or Enterprise Zone (EZ). However, NOLs generated in these incentive areas may only offset income generated in the incentive areas, and only one such NOL may be claimed in any year.

Special rules apply for taxpayers who have different types of NOLs generated in the same year. Generally, taxpayers operating in various tax incentive zones or within and outside tax incentive zones must allocate their overall loss between their various zone and non-zone activities. The deduction for such a taxpayer is limited to just the NOL from one particular zone loss to the exclusion of all other losses or to a carryforward of the entire loss under the general NOL rules.

This bill would incrementally increase the current 50% carryforward of the net operating loss (NOL) deduction as follows:

- For taxable and income years beginning before January 1, 2000, 50% of the NOL may be carried forward.
- For taxable and income years beginning on or after January 1, 2000, and before January 1, 2002, 55% of the NOL may be carried forward.
- For taxable and income years beginning on or after January 1, 2002, 60% of the NOL may be carried forward.

This bill would also increase the NOL carry forward period from the current five years to ten years for all NOLs generated for taxable and income years beginning on or after January 1, 2000.

Implementation Considerations

It is not uncommon for a taxpayer to operate more than one business. As a result, if one of the taxpayer's businesses is a "new business" and or "eligible small business," special rules apply for calculating the taxpayer's NOL.

Currently, a taxpayer that incurs a NOL attributable to a "new businesses" or an "eligible small businesses" is allowed to carry forward 100% of the NOL equal to the net loss of the "new business" or "eligible small business." If the taxpayer incurs additional losses attributable to other businesses, for that amount that exceeds the net loss of the "new business" or "eligible small business," the taxpayer is allowed to carry forward only 50% of the NOL. This bill does not increase that 50% carryforward amount.

In addition, "new businesses" are allowed to carryforward NOLs for eight years. For "new businesses," the carryforward would remain eight years, while other entities would receive a carryforward of ten years.

Upon discussion with the author's staff, staff indicated it was the author's intent to also increase the percentage of NOL carryforward to 55% and finally 60% for the NOL amount that exceeds the net "new business" or "eligible small business" NOL. Staff also indicated it was the author's intent to increase the carryforward for "new businesses" from eight years to ten years. Amendments 1 and 2 are provided below.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact departmental costs.

Tax Revenue Estimate

The revenue shown below is based on the author's intent to allow all business entities to carryover the increased amounts of their net operating losses for losses incurred in years beginning after December 31, 1999.

Revenue losses under the Personal Income Tax Law and the Bank & Corporation Tax Law are estimated to be:

Fiscal Year Cash Flow Impact Effective 1/1/00 Enactment Assumed After June 30, 2000 \$ Millions									
2000- 01	2001- 02	2002- 03	2003- 04	2004- 05	2005- 06	2006- 07	2007- 08	2008- 09	2009- 10
-\$1	-\$5	-\$17	-\$33	-\$48	-\$63	-\$80	-\$101	-\$125	-\$151

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

Revenue losses under the Personal Income Tax Law and Bank & Corporation Tax Law would depend on the amount of additional net operating loss deductions that can be applied against taxable income.

The above estimates are based on prior year tax return data which indicate the total amount of operating losses and the amounts that were applied under current law to reduce tax liabilities. This data was then simulated to determine how much additional losses could be applied under the higher phase-in limits.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR AB 1774
As Introduced January 20, 2000

AMENDMENT 1

On page 2, strikeout lines 3 to 26, inclusive, strikeout page 3 through page 15, inclusive, and on page 16, strikeout lines 1 to 25, inclusive, and insert:

17276. Except as provided in Sections 17276.1, 17276.2, 17276.4, 17276.5, and 17276.6, the deduction provided by Section 172 of the Internal Revenue Code, relating to a net operating loss deduction, shall be modified as follows:

(a)(1) Net operating losses attributable to taxable years beginning before January 1, 1987, shall not be allowed.

(2) A net operating loss shall not be carried forward to any taxable year beginning before January 1, 1987.

(b)(1) Except as provided in paragraphs (2) and (3), the provisions of Section 172(b)(2) of the Internal Revenue Code, relating to the amount of carryovers, shall be modified so that ~~50 percent~~ the applicable percentage of the entire amount of the net operating loss for any taxable year, shall ~~not~~ be eligible for carryover to any subsequent taxable year. For purposes of this subdivision, the applicable percentage shall be:

(A) Fifty percent for any taxable year beginning before January 1, 2000.

(B) Fifty-five percent for any taxable year beginning on or after January 1, 2000, and before January 1, 2002.

(C) Sixty percent for any taxable year beginning on or after January 1, 2002.

(2) In the case of a taxpayer who has a net operating loss in ~~a~~ any taxable year beginning on or after January 1, 1994, and who operates a new business during that taxable year, each of the following shall apply to each loss incurred during the first three taxable years of operating the new business:

(A) If the net operating loss is equal to or less than the net loss from the new business, 100 percent of the net operating loss shall be carried forward as provided in ~~paragraph (2) of~~ subdivision (d).

(B) If the net operating loss is greater than the net loss from the new business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the new business, 100 percent of that amount shall be carried forward as provided in ~~paragraph (2) of~~ subdivision (d).

(ii) With respect to the portion of the net operating loss which exceeds the net loss from the new business, ~~50 percent~~ the applicable percentage of that amount shall be carried forward as provided in subdivision (d) ~~a net operating loss carryover to each of the five taxable years following the taxable year of the loss.~~

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) ~~shall be absorbed before the~~ amount described in clause (i) of subparagraph (B) .

(3) In the case of a taxpayer who has a net operating loss in ~~a~~ any taxable year beginning on or after January 1, 1994, and who operates an eligible small business during that taxable year, each of the following shall apply:

(A) If the net operating loss is equal to or less than the net loss from the eligible small business, 100 percent of the net operating loss shall be carried forward to the taxable years specified in ~~paragraph (1) of~~ subdivision (d).

(B) If the net operating loss is greater than the net loss from the eligible small business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the eligible small business, 100 percent of that amount shall be carried forward ~~to each of the five taxable years following the taxable year of the loss~~ as specified in subdivision (d).

(ii) With respect to ~~the~~ that portion of the net operating loss that exceeds the net loss from the eligible small business, ~~50 percent~~ the applicable percentage of that amount shall be a net operating loss carryover to each of the five taxable years following the taxable year of the loss carried forward as provided in subdivision (d).

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(4) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates a business that qualifies as both a new business and an eligible small business under this section, that business shall be treated as a new business for the first three taxable years of the new business.

(5) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates more than one business, and more than one of those businesses qualifies as either a new business or an eligible small business under this section, paragraph (2) shall be applied first, except that if there is any remaining portion of the net operating loss after application of clause (i) of subparagraph (B) of that paragraph, paragraph (3) shall be applied to the remaining portion of the net operating loss as though that remaining portion of the net operating loss constituted the entire net operating loss.

(6) For purposes of this section, the term "net loss" means the amount of net loss after application of Sections 465 and 469 of the Internal Revenue Code.

(c) Net operating loss carrybacks shall not be allowed.

(d)(1) (A) ~~Except as provided in paragraphs (2) and (3)~~ For each a net operating loss for any taxable year beginning on or after January 1, 1987, and before January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute "five taxable years" in lieu of "15 taxable years," except as otherwise provided in paragraphs (2) and (3).

(B) For a net operating loss for any taxable year beginning on or after January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute "10 taxable years" in lieu of "20 taxable years."

(2) ~~In~~ For any taxable year beginning before January 1, 2000, in the case of a "new business," the "five taxable years" in paragraph (1) shall be modified to read as follows:

(A) "Eight taxable years" for a net operating loss attributable to the first taxable year of that new business.

(B) "Seven taxable years" for a net operating loss attributable to the second taxable year of that new business.

(C) "Six taxable years" for a net operating loss attributable to the third taxable year of that new business.

(3) For any carryover of a net operating loss for which a deduction is denied by Section 17276.3, the carryover period specified in this subdivision shall be extended as follows:

(A) By one year for a net operating loss attributable to taxable years beginning in 1991.

(B) By two years for a net operating loss attributable to taxable years beginning prior to January 1, 1991.

(4) The net operating loss attributable to taxable years beginning on or after January 1, 1987, and before January 1, 1994, shall be a net operating loss carryover to each of the 10 taxable years following the year of the loss if it is incurred by a taxpayer that is under the jurisdiction of the court in a Title 11 or similar case at any time during the income year. The loss carryover provided in the preceding sentence shall not apply to any loss incurred after the date the taxpayer is no longer under the jurisdiction of the court in a Title 11 or similar case.

(e) For purposes of this section:

(1) "Eligible small business" means any trade or business that has gross receipts, less returns and allowances, of less than one million dollars (\$1,000,000) during the taxable year.

(2) Except as provided in subdivision (f), "new business" means any trade or business activity that is first commenced in this state on or after January 1, 1994.

(3) "Title 11 or similar case" shall have the same meaning as in Section 368(a)(3) of the Internal Revenue Code.

(4) In the case of any trade or business activity conducted by a partnership or S corporation, paragraphs (1) and (2) shall be applied to the partnership or S corporation.

(f) For purposes of this section, in determining whether a trade or business activity qualifies as a new business under paragraph (2) of subdivision (e), the following rules shall apply:

(1) In any case where a taxpayer purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of entity) that is doing business in this state (within the meaning of Section 23101), the trade or business thereafter conducted by the taxpayer (or any related person) shall not be treated as a new business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by the taxpayer (or any related person) in the conduct of its trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the taxpayer (or any related person). For purposes of this paragraph only, the following rules shall apply:

(A) The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the first taxable year in which the taxpayer (or any related person) first uses any of the acquired trade or business assets in its business activity.

(B) Any acquired assets that constituted property described in Section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Section 1221(1) of the Internal Revenue Code in the hands of the acquiring taxpayer (or related person).

(2) In any case where a taxpayer (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months ("prior trade or business activity"), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the taxpayer's (or any related person's) current or prior trade or business activities.

(3) In any case where a taxpayer, including all related persons, is engaged in trade or business activities wholly outside of this state and the taxpayer first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in paragraph (1)), the trade or business activity shall be treated as a new business under paragraph (2) of subdivision (e).

(4) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the taxpayer as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of paragraph (1) of this subdivision.

(5) "Related person" shall mean any person that is related to the taxpayer under either Section 267 or 318 of the Internal Revenue Code.

(6) "Acquire" shall include any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.

(7) (A) For taxable years beginning on or after January 1, 1997, the term "new business" shall include any taxpayer that is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and as further amended, and that has not received regulatory approval for any product from the United States Food and Drug Administration.

(B) For purposes of this paragraph:

(i) "Biopharmaceutical activities" means those activities which use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities which make use of chemical compounds to produce commercial products.

(ii) "Other biotechnology activities" means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(g) In computing the modifications under Section 172(d)(2) of the Internal Revenue Code, relating to capital gains and losses of taxpayers other than corporations, the exclusion provided by Section 18152.5 shall not be allowed.

(h) Notwithstanding any provisions of this section, a deduction shall be allowed to a "qualified taxpayer" as provided in Sections 17276.1, 17276.2, 17276.4, 17276.5, and 17276.6.

(i) The Franchise Tax Board may prescribe appropriate regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, tiered ownership structures, or otherwise.

(j) The Franchise Tax Board may reclassify any net operating loss carryover determined under either paragraph (2) or (3) of subdivision (b) as a net operating loss carryover under paragraph (1) of subdivision (b) upon a showing that the reclassification is necessary to prevent evasion of the purposes of this section.

~~(k) The amendments made by the act adding this subdivision shall be operative for taxable years beginning on or after January 1, 1997~~

(k) Except as otherwise provided, the amendments made by the act adding this subdivision shall apply to net operating losses for taxable years beginning on or after January 1, 2000.

SECTION 2. Section 24416 of the Revenue and Taxation Code is amended to read:

24416. Except as provided in Section 24416.1, 24416.2, 24416.4, 24416.5, or 24416.6, a net operating loss deduction shall be allowed in computing net income under Section 24341 and shall be determined in accordance with Section 172 of the Internal Revenue Code, except as otherwise provided.

(a) (1) Net operating losses attributable to income years beginning before January 1, 1987, shall not be allowed.

(2) A net operating loss shall not be carried forward to any income year beginning before January 1, 1987.

(b) (1) Except as provided in paragraphs (2) and (3), the provisions of Section 172(b)(2) of the Internal Revenue Code, relating to the amount of carryovers, shall be modified so that 50 percent the applicable percentage of the entire amount of the net operating loss for any income year, shall ~~not~~ be eligible for carryover to any subsequent income year. For purposes of this subdivision, the applicable percentage shall be:

(A) Fifty percent for any income year beginning before January 1, 2000.

(B) Fifty-five percent for any income year beginning on or after January 1, 2000, and before January 1, 2002.

(C) Sixty percent for any income year beginning on or after January 1, 2002.

(2) In the case of a taxpayer who has a net operating loss in ~~an~~ any income year beginning on or after January 1, 1994, and who operates a new business during that income year, each of the following shall apply to each loss incurred during the first three income years of operating the new business:

(A) If the net operating loss is equal to or less than the net loss from the new business, 100 percent of the net operating loss shall be carried forward as provided in ~~paragraph (2) of~~ subdivision (e).

(B) If the net operating loss is greater than the net loss from the new business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the new business, 100 percent of that amount shall be carried forward as provided in ~~paragraph (2) of~~ subdivision (e).

(ii) With respect to the portion of the net operating loss that exceeds the net loss from the new business, 50 percent the applicable percentage of that amount shall be ~~a net operating loss carryover to each of the five income years following the income year of the loss~~ carried forward as provided in subdivision (d).

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(3) In the case of a taxpayer who has a net operating loss in ~~an~~ any income year beginning on or after January 1, 1994, and who operates an eligible small business during that income year, each of the following shall apply:

(A) If the net operating loss is equal to or less than the net loss from the eligible small business, 100 percent of the net operating loss shall be carried forward to the income years specified in paragraph (1) of subdivision (e).

(B) If the net operating loss is greater than the net loss from the eligible small business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the eligible small business, 100 percent of that amount shall be carried forward to ~~each of the five income years following the income year of the loss as~~ specified in subdivision (e).

(ii) With respect to ~~the~~ that portion of the net operating loss that exceeds the net loss from the eligible small business, ~~50 percent~~ the applicable percentage of that amount shall be a net operating loss carryover to each of the five income years following the income year of the loss carried forward as provided in subdivision (e).

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B)—shall be absorbed before the amount described in clause (i) of subparagraph (B).

(4) In the case of a taxpayer who has a net operating loss in an income year beginning on or after January 1, 1994, and who operates a business that qualifies as both a new business and an eligible small business under this section, that business shall be treated as a new business for the first three income years of the new business.

(5) In the case of a taxpayer who has a net operating loss in a income year beginning on or after January 1, 1994, and who operates more than one business, and more than one of those businesses qualifies as either a new business or an eligible small business under this section, paragraph (2) shall be applied first, except that if there is any remaining portion of the net operating loss after application of clause (i) of subparagraph (B) of that paragraph, paragraph (3) shall be applied to the remaining portion of the net operating loss as though that remaining portion of the net operating loss constituted the entire net operating loss.

(6) For purposes of this section, "net loss" means the amount of net loss after application of Sections 465 and 469 of the Internal Revenue Code.

(c) For any income year in which the taxpayer has in effect a water's-edge election under Section 25110, the deduction of a net operating loss carryover shall be denied to the extent that the net operating loss carryover was determined by taking into account the income and factors of an affiliated corporation in a combined report whose income and apportionment factors would not have been taken into account if a water's-edge election under Section 25110 had been in effect for the income year in which the loss was incurred.

(d) Net operating loss carrybacks shall not be allowed.

(e) (A) ~~Except as provided in paragraphs (2), (3) and (4) f~~For each a net operating loss for any income year beginning on or after January 1, 1987, and before January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute "five income years" in lieu of "15 income years—" except as otherwise provided in paragraphs (2), (3) and (4).

(B) For a net operating loss for any income year beginning on or after January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute "10 income years" in lieu of "20 income years."

(2)~~In~~ For any income year beginning before January 1, 2000, in the case of a "new business," the "five income years" in paragraph (1) shall be modified to read as follows:

(A) "Eight income years" for a net operating loss attributable to the first income year of that new business.

(B) "Seven income years" for a net operating loss attributable to the second income year of that new business.

(C) "Six income years" for a net operating loss attributable to the third income year of that new business.

(3) For any carryover of a net operating loss for which a deduction is denied by Section 24416.3, the carryover period specified in this subdivision shall be extended as follows:

(A) By one year for a net operating loss attributable to income years beginning in 1991.

(B) By two years for a net operating loss attributable to income years beginning prior to January 1, 1991.

(4) The net operating loss attributable to income years beginning on or after January 1, 1987, and before January 1, 1994, shall be a net operating loss carryover to each of the 10 income years following the year of the loss if it is incurred by a corporation that was either of the following:

(A) Under the jurisdiction of the court in a Title 11 or similar case at any time prior to January 1, 1994. The loss carryover provided in the preceding sentence shall not apply to any loss incurred in an income year after the income year during which the corporation is no longer under the jurisdiction of the court in a Title 11 or similar case.

(B) In receipt of assets acquired in a transaction that qualifies as a tax-free reorganization under Section 368(a)(1)(G) of the Internal Revenue Code.

(f) For purposes of this section:

(1) "Eligible small business" means any trade or business that has gross receipts, less returns and allowances, of less than one million dollars (\$1,000,000) during the income year.

(2) Except as provided in subdivision (g), "new business" means any trade or business activity that is first commenced in this state on or after January 1, 1994.

(3) "Title 11 or similar case" shall have the same meaning as in Section 368(a)(3) of the Internal Revenue Code.

(4) In the case of any trade or business activity conducted by a partnership or an S corporation, paragraphs (1) and (2) shall be applied to the partnership or S corporation.

(g) For purposes of this section, in determining whether a trade or business activity qualifies as a new business under paragraph (2) of subdivision (e), the following rules shall apply:

(1) In any case where a taxpayer purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of entity) that is doing business in this state (within the meaning of Section 23101), the trade or business thereafter conducted by the taxpayer (or any related person) shall not be treated as a new business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by the taxpayer (or any related person) in the conduct of its trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the taxpayer (or any related person). For purposes of this paragraph only, the following rules shall apply:

(A) The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the first income year in which the taxpayer (or any related person) first uses any of the acquired trade or business assets in its business activity.

(B) Any acquired assets that constituted property described in Section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Section 1221(1) of the Internal Revenue Code in the hands of the acquiring taxpayer (or related person).

(2) In any case where a taxpayer (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months ("prior trade or business activity"), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the taxpayer's (or any related person's) current or prior trade or business activities.

(3) In any case where a taxpayer, including all related persons, is engaged in trade or business activities wholly outside of this state and the taxpayer first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in paragraph (1)), the trade or business activity shall be treated as a new business under paragraph (2) of subdivision (e).

(4) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the taxpayer as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of paragraph (1) of this subdivision.

(5) "Related person" shall mean any person that is related to the taxpayer under either Section 267 or 318 of the Internal Revenue Code.

(6) "Acquire" shall include any transfer, whether or not for consideration.

(7) (A) For income years beginning on or after January 1, 1997, the term "new business" shall include any taxpayer that is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and as further amended, and that has not received regulatory approval for any product from the United States Food and Drug Administration.

(B) For purposes of this paragraph:

(i) "Biopharmaceutical activities" means those activities which use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities which make use of chemical compounds to produce commercial products.

(ii) "Other biotechnology activities" means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(h) For purposes of corporations whose net income is determined under Chapter 17 (commencing with Section 25101), Section 25108 shall apply to each of the following:

(1) The amount of net operating loss incurred in any income year which may be carried forward to another income year.

(2) The amount of any loss carries forward which may be deducted in any income year.

(i) The provisions of Section 172(b)(1)(D) of the Internal Revenue Code, relating to bad debt losses of commercial banks, shall not be applicable.

(j) The Franchise Tax Board may prescribe appropriate regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, tiered ownership structures, or otherwise.

(k) The Franchise Tax Board may reclassify any net operating loss carryover determined under either paragraph (2) or (3) of subdivision (b) as a net operating loss carryover under paragraph (1) of subdivision (b) upon a showing that the reclassification is necessary to prevent evasion of the purposes of this section.

~~(1) The amendments made by the act adding this subdivision shall be operative for income years beginning on or after January 1, 1997.~~

(1) Except as otherwise provided, the amendments made by the act adding this subdivision shall apply to net operating losses for income years beginning on or after January 1, 2000.